

**Guam Economic Development Authority
Qualifying Certificate Program**

**Performance Audit
October 1, 2007 through December 31, 2012**

**OPA Report No. 13-02
August 2013**



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EXECUTIVE SUMMARY
Guam Economic Development Authority's Qualifying Certificate Program
OPA Report No. 13-02, August 2013

Our audit of the Guam Economic Development Authority (GEDA)'s Qualifying Certificate (QC) Program revealed: (1) the total financial impact (foregone tax revenues versus economic benefit to Guam) of the QC program is unknown; (2) QCs awarded to the insurance industry are more generous and are awarded regardless of the economic impact to the Government of Guam (GovGuam); (3) a tax benefit may have been granted to an ineligible QC beneficiary; and (4) tax benefits were not processed in accordance with law. These conditions occurred because: GEDA did not develop a reliable and complete database and did not utilize QC program statistics; part of QC's law intent was to establish Guam as a financial/insurance center for the Pacific; GEDA did not verify whether beneficiaries met certain requirements; the Department of Revenue and Taxation (DRT) processed applications without independent review and verification; and both GEDA and DRT were untimely in their review of beneficiary compliance to QC terms and application of tax benefits.

Once deemed eligible, GEDA provides a QC applicant the maximum tax benefits allowed under law. Of the 23 QC beneficiaries in existence, we tested six and determined that GovGuam provided tax benefits of at least \$21.7 million (M) from 2008 to 2011. Tax information for some of these six beneficiaries was incomplete due to missing information from DRT. The tax benefits consisted of \$15.4M in income tax rebates, \$6M in Gross Receipt Tax (GRT) abatements, and \$358 thousand in real property tax abatements. By industry, of this \$21.7M, the lion's share (78% or \$17.1M) of the tax benefits were granted to the insurance QC beneficiaries. In its September 2011 audit report, the Department of the Interior, Office of Inspector General, concluded, and we concur, that the Legislature granted GEDA sufficient flexibility to decide the terms and conditions of QCs and did not limit GEDA to only grant QCs for the maximum allowable level of tax benefits. However, it has been GEDA's practice to grant the maximum benefits under the law. Additionally, GEDA management stated that despite their opposition, the QC law was expanded to include domestic insurance beneficiaries.

Financial Impact of QC Program is Unknown

Despite the QC program being in effect for nearly 50 years, we could not determine the positive or negative financial impact of the QC program due to GEDA and DRT's unverifiable and incomplete database. Specifically, we found that: (1) GEDA did not independently verify certain information provided by QC beneficiaries; (2) GEDA has yet to provide us access to the database to enable us to verify information from source documents; and (3) GEDA and DRT did not collaborate to compile information on the amount of forgone tax revenues as a result of issuing QCs. Under the current administration, GEDA is now in the process of developing QC-related statistics.

GEDA also indicated that the amount of forgone taxes should come from DRT due to the confidential nature of taxes and DRT's responsibility of authorizing the amount of tax benefits. For the six beneficiaries tested, we independently compiled tax data but were unable to reconcile

with the DRT-provided data. DRT was unable to provide 2011 income tax returns for Beneficiary 3 and 5. DRT was unable to provide Beneficiary 1 and 2's GRT returns from February to March, May, and July to December 2011.

QCs Awarded to Insurance Industry Regardless of Economic Impact to GovGuam

The QC law provides generous tax benefits to the insurance industry than other industries we reviewed. This includes the ability for their QCs to be automatically renewed for an additional 20 years if found to be in good standing. Despite the development of an economic model and the results calculated by such model, GEDA stated that they could not prevent an eligible applicant from receiving all tax benefits allowed by law. For example, GEDA calculated one QC to provide \$6.4M in taxes over a 20-year period; however, the forgone tax revenues to GovGuam over the same period amounted to \$101.6M, for an economic loss of \$95.2M. A moratorium on the QC program from 2007 to 2008 reflected the need for improvements on the existing provisions of the program. Although the moratorium was lifted, some issues on the QC law such as the automatic renewal clause for insurance QC beneficiaries remained unaddressed. As stated earlier, GEDA management opposed the amendment to include domestic insurance beneficiaries.

Ineligible Benefit May Have Been Granted to a QC Beneficiary

GEDA and DRT staff may have granted a tax benefit to an insurance QC beneficiary not in accordance with law. We found GEDA authorized a 100% rebate to this beneficiary although its policies were not issued through a licensed broker. We also found DRT processed the rebate without independent verification of whether the beneficiary was entitled to receive such benefit. This occurred due to lack of oversight and understanding of the benefit requirements by GEDA and DRT.

Tax Benefits Not Processed in Accordance with Legal Requirements

As much as \$9.1M of income tax rebates were incorrectly applied by QC beneficiaries and \$5.5M in GRT taxes were exempted instead of abated. We found no evidence that DRT verified such amounts. Specifically, income tax rebates were used as off-sets and GRTs were exempted without DRT's certification or authorization as required by laws and regulations. These deficiencies are attributed to no cash in the Income Tax Rebate Fund; GEDA and DRT's untimely review; and DRT's lack of monitoring and review.

Conclusion and Recommendations

To improve the QC program's effectiveness, we recommend: (1) GEDA and DRT collaborate to compile, analyze, and post data on the QC program; (2) the Governor, the Legislature, and the GEDA and DRT Directors to revisit the QC law for elimination of the application of QCs to the domestic insurance industry; and (3) DRT, as the tax administrator, to perform its own due diligence in determining the appropriate tax benefits of eligible QC beneficiaries.



Doris Flores Brooks, CPA, CGFM
Public Auditor



Introduction

This report presents the results of our audit of the Guam Economic Development Authority (GEDA) Qualifying Certificate (QC) program from October 1, 2007 to December 31, 2012. The audit was initiated at the request of a Senator from the 31st Guam Legislature after concerns were raised regarding the effectiveness of GEDA's QC program. Our audit objectives were to determine: (1) the financial impact of issued QCs to Guam's economy and (2) whether GEDA administered the QC program in compliance with applicable laws and regulations. The objective, scope, methodology, and prior audit coverage are detailed in Appendices 2 and 3.

Background

GEDA is a public corporation responsible for the centralized direction, control, and supervision of an integrated plan for the economic development of Guam. GEDA's QC program is an economic incentive tool to encourage companies to invest in Guam (Title 12 of the Guam Code Annotated (GCA) Chapter 58, hereafter referred to as the "QC law"). The program's corporate income tax and dividends tax rebates, and real property tax abatements contributed to the development of the tourism industry and now supports the growth of new and emerging industries. Under the program, a QC is given to eligible beneficiaries.

The QC serves as a contract valid for a certain time period, executed by the Governor upon GEDA's recommendation, between the Government of Guam (GovGuam) and the eligible beneficiary for certain tax benefits in return for meeting certain requirements in the QC law and in the QC (12 GCA §58101). "No QC shall be issued unless" GEDA finds that the beneficiary's proposed activity "shall promote the general economic development" of Guam by: (1) creation of employment and, (2) replacement of imports, (3) reduction in consumer prices, (4) creation of affordable housing or other vitally needed facilities, (5) creation of economic activity of value to Guam, or (6) establishment of Guam as the financial/insurance center for the Pacific (12 GCA §§58105, 58105.1, 58105.2, 58105.3, 58105.4, 58105.5, and 58105.6). Refer to Appendix 4 for applicable laws and regulations.

GEDA's QC program is administered by its Business Development and Marketing Division and Program and Compliance Division, and by the Department of Revenue and Taxation (DRT). The Business Development and Marketing Division processes QC applications and recommends the issuance of QCs to the Governor. The Program and Compliance Division monitors the compliance of beneficiaries with QC terms and applicable laws and regulations. DRT processes the tax rebates and abatements of compliant QC beneficiaries. Refer to Appendix 5 for GEDA and DRT's Flow Chart Summaries of their Standard Operating Procedures.

Results of Audit

Our audit of the Guam Economic Development Authority (GEDA)'s Qualifying Certificate (QC) Program revealed:

1. The financial impact of the QC program is unknown;
2. QCs are awarded regardless of economic impact to the GovGuam and insurance industries receive more generous tax benefits than other industries;
3. A tax benefit may have been granted to an ineligible QC beneficiary; and
4. Tax benefits were not processed in accordance with law.

These conditions occurred because GEDA did not: develop a reliable and complete database, utilize QC program statistics, verify whether beneficiaries met certain requirements, and timely perform its annual reviews of QC beneficiary compliance. The law was expanded so that Guam could attract and become a financial insurance center in the Pacific, which GEDA management opposed such amendment. DRT also untimely processed and did not perform its due diligence in administering the tax benefits of QC beneficiaries.

Once deemed eligible, GEDA provides a QC applicant the maximum tax benefits allowed under law. However, we concur with what the Department of the Interior Office of Inspector General (DOI-OIG) concluded in their September 2001 audit report,¹ that based on the law, the Legislature granted GEDA sufficient flexibility to decide the terms and conditions of QC and did not limit GEDA to granting QCs at only the maximum allowable level of tax benefits.

Of the 23 QC beneficiaries, we tested six and estimated GovGuam provided tax benefits totaling \$21.7 million (M) from 2008 to 2011. The tax benefits consisted of \$15.4M in income tax rebates, \$6M in Gross Receipt Tax (GRT) abatements, and \$358 thousand (K) in real property tax abatements. By industry, of this \$21.7M, the lion's share (78% or \$17.1M) of the tax benefits were granted to the insurance QC beneficiaries.

Financial Impact of QC Program is Unknown

Despite the QC program being in effect for nearly 50 years, we could not determine the financial impact of the QC program due to GEDA and DRT's unreliable and incomplete database. Specifically, we found that: (1) GEDA did not independently verify certain information provided by QC beneficiaries; (2) GEDA has yet to release information contained in GEDA's database; and (3) GEDA and DRT did not collaborate to compile information on the amount of forgone tax revenues and tax benefits as a result of issuing QCs.

Prudent management entails accountability of a program's performance, which is measured by establishing performance expectations and then gathering, maintaining, and tracking key data to determine if the expectations are accomplished. Maintaining a complete and reliable database is incumbent upon management as a means of tracking performance measures, which in turn will be compared to the expectations to determine if the organization's current system is working

¹ Report No. 01-I-419: Qualifying Certificate Program, Guam Economic Development Authority, Government of Guam. See the Executive Summary of this report at Appendix 6.

adequately. Performance information is even more vital in today's economy, when there is an increasing demand for transparency and greater scrutiny of an organization's business practices².

Unverifiable and Incomplete GEDA Database

We requested that GEDA provide information on QC beneficiaries, including the: (1) total amount of investments made to Guam's economy, (2) number of jobs created, and (3) total amount of compensation for the jobs created by each active beneficiary between fiscal years (FY) 2008 and 2012. Based on the information submitted by GEDA, we could not ascertain the validity or reliability of the data provided as GEDA did not independently verify certain information provided by QC beneficiaries and has yet to provide us access to the database to enable us to verify information from source documents.

For example, according to GEDA, 23 beneficiaries invested approximately \$375.5M by creating or moving their businesses or earning insurance premiums in Guam. There is no standard basis as to what should be considered in reporting investment amounts on the beneficiaries' QC application forms. In addition, GEDA does not compile the actual amounts invested to compare with the estimated amount initially reported. This comparison could help GEDA make improved decisions, especially when the same beneficiaries apply for a renewal of their QCs.

In another example, GEDA also reported that from FY 2008 to 2012, the 23 beneficiaries created a total of 11,758³ jobs and provided a total job compensation of \$440M³. Similar to the investment amount, the number of jobs and amount of job compensation were derived from the beneficiaries' required monthly reports. Based on our walkthrough, GEDA compiles the information into a database and verifies the information from the beneficiaries' payroll records. However, GEDA has yet to analyze the data to determine whether the number of jobs created excludes the number of jobs maintained over the year.

In addition, we requested to review the monthly reports and GEDA's database information of the six beneficiaries we selected. GEDA management stated that the database remains in development and it would not be prudent for GEDA to release it to our office. During our walkthrough, we found that GEDA's database only contains information from 2008 to 2012. According to GEDA, data dating back past 2007 has not been incorporated into GEDA's current database as this was a prospective project moving forward by GEDA's current administration.

We also noted that GEDA's database does not contain beneficiaries' tax information. Although beneficiaries submit a copy of their filed tax returns to GEDA, GEDA does not compile the amount of tax revenues forgone as a result of issuing QCs. According to GEDA, the amount of forgone taxes should be compiled and reported by DRT due to the confidential nature of taxes and DRT's responsibility of authorizing the amount of tax benefits. Although GEDA stated that they are unable to obtain the amount of foregone taxes, DRT's position is that they can release tax information by industry which at this summary level would protect taxpayer confidentiality. GEDA should have been collaborating with DRT to include a summary of the taxes forgone and tax benefits derived from QC activities in the GEDA database.

² Performance Management and Measurement by the U.S. Department of Health and Human Services Health Resources and Services Administration: <http://www.hrsa.gov>

³ This data may include amounts outside of our scope and may be reflective of amounts estimated for the life of each of the 23 beneficiaries' QCs.

GEDA management has acknowledged the importance of tracking QC-related benefits in comparison to forgone tax revenues and is working with its staff in its newly created Economic Research Division to assist in determining the necessary information needed to assess the economic benefits of the QC program.

Unverifiable and Incomplete DRT Database

We requested DRT to provide the amount of tax revenues foregone based on the benefits granted to QC beneficiaries from 2008 to 2012. DRT staff provided a spreadsheet of the amount of income taxes rebated and GRT abated approximately four months later. For the six beneficiaries tested, we independently compiled tax data and were unable to reconcile our compilation with the data DRT had provided. Beneficiary 3 was missing from DRT’s list of income tax rebates. In addition, DRT’s list of GRT abatements showed the total assessed GRT, not just the amounts abated or exempted.

DRT was also unable to provide 2011 income tax returns for two of the tested beneficiaries. In addition, Beneficiary 1 and 2’s GRT returns from February to March, May, and July to December 2011 were missing. Furthermore, DRT’s certification to the taxpayer confirming the nature and amount of abated GRTs from 2009 to 2011 was not on file. Refer to the table below for a summary of the data we compiled based on available information and Appendix 6 for details.

Table 1: Total Tax Benefits⁴ of Six QC Beneficiary Samples (Tax Years 2008 to 2012⁵)

Type of Tax Benefits	2008	2009	2010	2011	2012	Totals
20 yrs. 100% Corporate Tax Rebate	Provided	Provided	Provided	Provided	MISSING	\$ 11,038,931
16 yrs. 75% Corporate Tax Rebate	Provided	Provided	Provided	MISSING	MISSING	\$ 4,326,040
20 yrs. 100% GRT Abatement	Provided	Provided	Provided	Provided	MISSING	\$ 6,012,503
5 yrs. 100% Real Property Tax Abatement	Provided	Provided	Provided	Provided	MISSING	\$ 358,052
Total	\$ 3,823,815	\$ 5,335,637	\$ 8,303,235	\$ 4,272,839	\$ -	\$ 21,735,526

For two of the QC beneficiaries, DRT was unable to provide complete GRT returns; therefore, we were unable to quantify the total tax benefits given to the six QC beneficiaries we tested. We verified that at least \$21.7M was granted in tax benefits from 2009 to 2011. Accordingly, DRT needs to evaluate their capacity to maintain a complete and organized filing system.

During our review, we noted that one person was assigned to collect, calculate, and maintain data for the QC program along with their primary tasks and duties since 2010. OPA has often referred to the heavy reliance on one “single point of contact” as a “single point of failure,” since the entire process is severed should this person be on leave or on training. During our review of the files, other DRT staffs were unable to answer our questions when the staff handling the QC program was absent.

DRT management indicated that information could have been readily available for this audit and future audits if mandatory electronic filing of taxes is implemented. As previously mentioned in OPA Report No. 13-01, Department of Revenue and Taxation Gross Receipts Tax Exemptions, e-filing allows taxpayers to input the correct data at the onset of filing, which would be

⁴ Detailed amounts are not disclosed due to confidential tax payer information.

⁵ Tax Year 2012 tax forms were not available for our review as the filing due date was subsequent to our fieldwork testing.

efficiently recorded into DRT's system. Similar to the recommendation made in OPA Report No. 13-01, we urge for DRT to establish and meet a specific target date for the transition to full e-filing of GRT forms.

A complete database is needed to help assess the effectiveness of the QC program. GEDA has information on the application and compliance aspects of the QC program. DRT has information on the tax benefits provided to QC beneficiaries. The information needs to be completed, consolidated, and analyzed in order to make informed decisions about the QC program and to make the costs and benefits of the program transparent. Therefore, we recommend for GEDA and DRT to collaborate to compile, analyze, and post the data on the QC program.

QCs Awarded to Insurance Industry Regardless of Economic Impact to GovGuam

The QC law provides more generous tax benefits to the insurance industry than to other industries. This includes the ability for their QCs to be renewed for an additional 20-year period, if determined to be in good standing. Despite the development of an economic model and the results calculated by such model, GEDA stated that they could not prevent an eligible applicant from receiving all tax benefits allowed by law. Despite GEDA's estimated economic loss of \$95.2M, a QC was awarded to an insurance beneficiary.

In determining whether to recommend that a QC be issued to an applicant, GEDA must make findings on the (1) impact, (2) financial risks, (3) location, and (4) economic importance of the beneficiary's proposed activities to Guam (12 GCA §58109). To support its findings, GEDA developed an economic model to show the cost and benefit of issuing a QC to an applicant. GEDA's economic model attempts to calculate the amount of taxes paid and forgone over the life of the QC. The model uses figures based on the applicant's projected financials for the QC term.

In one of the two insurance beneficiary files tested, GEDA's economic model projected Beneficiary 1's QC would not result in a net economic benefit as taxes forgone by the QC would be greater than taxes derived from the QC. For a 20-year period, the model showed the amount of other taxes paid to GovGuam at \$6.4M and the amount of forgone tax revenues at \$101.6M for an economic loss of \$95.2M. The model was calculated based on the applicant's requested tax benefits of 100% income tax rebate, 100% GRT abatement, and 75% dividend income tax rebate. However, we note that the applicant did not request for, but was granted, an additional 100% dividend income tax rebate for non-United States (U.S.) resident shareholders.

According to GEDA, although issuing a QC to the applicant will erode the tax base, GEDA could not prevent an eligible applicant from receiving all tax benefits allowed by law. On July 1996, despite GEDA's opposition, Public Law (PL) 23-109 was enacted to provide the opportunity for all insurance companies to apply for tax benefits offered by GEDA's QC program. The Legislature found that "one of the most attractive economic opportunities available to the island is to use its [Guam's] unique geographic location to become a financial/insurance capital of the Pacific". It was the legislature's intent to persuade "insurance issuers, whether reinsurer, commercial insurers, or so-called 'captive insurers' to locate their Pacific headquarters in Guam." Since then, insurance companies began to dominate the number of QC beneficiaries. Therefore, regardless of the economic loss or benefit resulting from the issuance of a QC to an insurance company, a QC will be granted for applicants in this industry.

In addition, we found that beneficiaries from the insurance industry consistently received the most number of QC benefits. These benefits were:

1. 20 years of 100% corporate tax rebate (12 GCA §58128.4(a));
2. 20 years of 100% GRT abatement (12 GCA §58127.5);
3. 20 years of 100% of income tax rebate from payments made by non-U.S. resident shareholders on corporate dividends (12 GCA §58128.4(b)); and
4. 5 years of 75% of income tax rebate from payments made by U.S. resident shareholders on corporate dividends (12 GCA §58130).

Like the DOI-OIG concluded in their audit Report No. 01-I-419, based on the law, we believe that the Legislature granted GEDA sufficient flexibility to decide the terms and conditions of QCs and did not limit GEDA to granting QC only for the maximum allowable level of tax benefits.

It was also noted in the DOI-OIG audit report that the QC law appears to give GEDA adequate legal authority to negotiate the level of QC benefits, terms, and conditions with applicants. However, because GEDA has not often issued QC with tax benefits at levels less than the maximums allowable, it may be beneficial to amend the QC law to clearly delineate the circumstances under which lower-than-maximum-level tax benefits can be granted.

Another benefit enjoyed by insurance QC beneficiaries was that the law also allows automatic renewal upon good standing. According to 12 GCA §58127.5 and §58128.4, “Such insurance QCs may be renewed for additional periods of 20 years at the conclusion of the first or later periods so long as the Beneficiary remains in good standing under the laws of Guam and under the rules and regulations of the Authority.” Unlike insurance QCs, the law does not provide an option for other industries we reviewed to renew QCs solely on good standing. All other renewals are subject to the same procedures and considerations as when they first applied for the QC. This may contribute to insurance beneficiaries comprising 48%, or 11 of 23 of the QCs, between FY 2008 and FY 2012. The other beneficiaries were from the hotel and attraction (9 or 39%), and other (3 or 13%) industries.

In 2008, GEDA submitted a briefing to the QC Review Sub-Committee. The briefing contained GEDA’s proposed deletion of the renewal clause for insurance QC beneficiaries from the QC law. According to GEDA, this clause allows insurance QC beneficiaries to receive tax benefits in perpetuity and does not allow the government any opportunity to conduct any type of review or due diligence.

Accordingly, we recommend that the Governor, the Legislature, and the GEDA and DRT Directors to revisit the QC law for elimination of the application of QCs to the domestic insurance industry. As stated previously, GEDA opposed the expansion in law of the QC program to the domestic insurance companies.

Improvements on the Economic Model Needed

Concerns with the QC program prompted the Legislature to place a moratorium on the issuance of QCs, except for the captive insurance industry, from October 2007 to July 31, 2008 through PL 29-19. The moratorium was for a QC Review Sub-Committee to conduct an extensive review of the program relative to present economic realities and to improve the existing provisions of the program. The QC Review Sub-Committee consisted of private and public sector

representatives. The moratorium was subsequently lifted as the QC Review Sub-Committee submitted its report to the Legislature. The report was supportive of maintaining and improving the QC program through proposed changes to the QC law.

As a result of the moratorium, GEDA established a Memorandum of Understanding with the University of Guam (UOG) to develop a network to generate timely, current economic data and business resources. Through this collaboration, UOG produced a report in July 2008 on “Analyzing the Economic/Fiscal Impact of the Qualifying Certificate Program”. The report focused on developing a method for evaluating QC applications using a cost-benefit analysis, and determining the appropriate level of tax incentives to be provided to QC beneficiaries using a scoring system. Due to confidentiality issues, the report was limited to only provide instructions on how to set-up the cost-benefit analysis and scoring system.

Despite UOG’s efforts, GEDA did not use the report for evaluating QCs. During our walkthrough, GEDA indicated that the report did not consider all factors associated with QCs and so, was not implementable. In place of the report, GEDA is currently using its own economic model and is in the process of hiring an economist to assist with their recently established Economic Research Division.

Incomplete Application File

According to 12 GCA §58126, GEDA’s recommendation and supporting memorandum of findings for QC issuance shall be forwarded to the Governor of Guam. If the Governor of Guam does not approve GEDA’s recommendation within 60 calendar days from the date of his receipt, the recommendation shall be deemed disapproved on the 61st day.

For two of the six beneficiary files we reviewed, although the QCs were signed by the Governor, we could not determine whether or not their QCs were approved in accordance with the law as supporting documentation was not in the file. Specifically, GEDA initially was unable to locate Beneficiary 3’s file. This QC was effective February 2008 and was the most recently issued QC in its industry, yet the file could not be found for our review. Three months after our request, GEDA notified us that they have located the file. However, like Beneficiary 1’s file, Beneficiary 3’s file did not contain any evidence of GEDA issuing its recommendations to the Governor.

Ineligible Benefit May Have Been Granted to an Insurance Beneficiary

GEDA and DRT staff may have granted a tax benefit not in accordance with legal requirements. We found GEDA authorized a 100% rebate that a beneficiary was not entitled to. We also found DRT merely processed the rebate without independent verification of whether the beneficiary was entitled to receive such benefit. This occurred due to lack of oversight of the benefit requirements by GEDA and DRT. According to GEDA, “Compliance is the cornerstone of the QC Program”, and GEDA in cooperation with DRT are charged with monitoring and reviewing all beneficiaries throughout the lifetime of the QC.

GEDA’s Lack of Oversight

Title 12 GCA §58128.4(a) allows for a rebate of 100% of income taxes from insurance underwriting in or out of Guam, as long as the beneficiary issues Guam risks and policies through a licensed Guam insurance broker. This benefit was granted to all insurance beneficiaries; however, it appears that GEDA did not apply these legal requirements prior to awarding the 100% rebate. Of the two insurance beneficiary files tested, we found evidence that

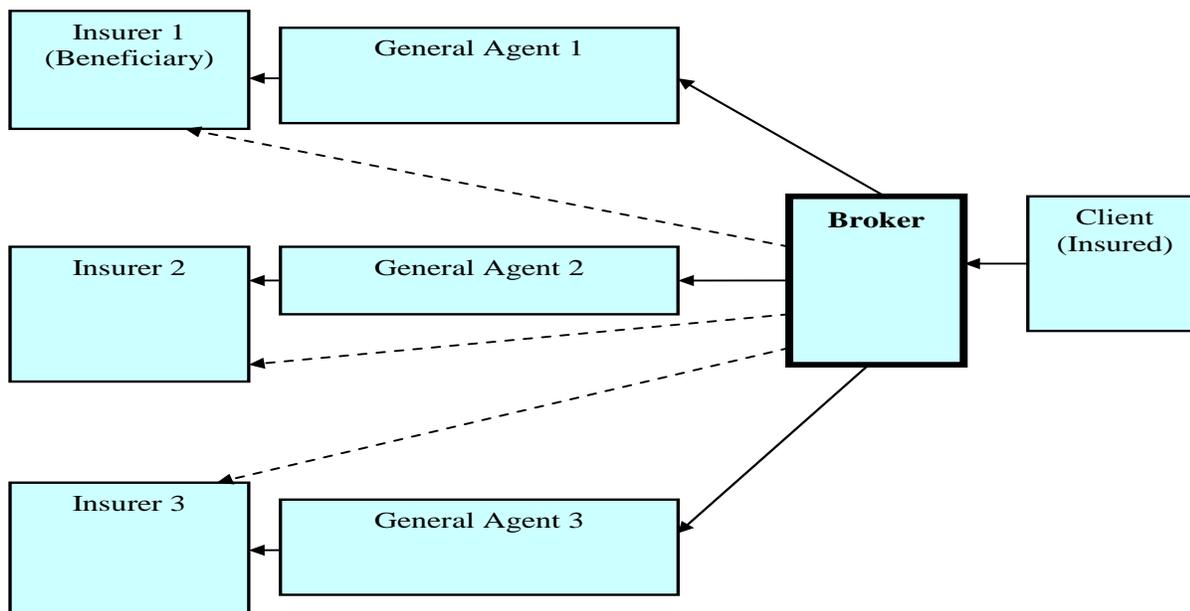
GEDA was only aware that Beneficiary 2’s policies were being issued through a *General Agent* rather than a *Broker*, prior to granting the 100% rebate benefit. A license for general agent is not the same as a license for a broker.

According to Guam insurance laws, the term “broker” means a person who, for compensation and on behalf of another person, transacts insurance business other than as insurer, general agent, sub-agent, or solicitor (22 GCA §12104(j)). While “general agent” means a person authorized by an insurer⁶ to countersign, issue and deliver new policies, to accept service of process on behalf of the insurer, and vested with full authority to consummate a contract of insurance and to transact all other necessary business of the insurer in Guam (5 GCA §12104(p)). In other words, an insurance broker represents the insured, while an insurance general agent represents the insurance company. Due to the difference in representation, agents are provided with different powers in insurance transactions than those of brokers, “such as the power to bind coverage”.⁷ See Diagram 1 and 2 below for an illustration of the difference between a general agent and a broker.

Diagram 1: General Agent



Diagram 2: Insurance Broker⁸



⁶ The term “insurer” means a person who undertakes to indemnify another by insurance (22 G.C.A. §12104(r)).

⁷ What Is the Difference in Insurance Agents & Insurance Brokers? Retrieved from http://www.ehow.co.uk/about_5594956_mga-insurance.html

⁸ Note: The dotted lines represent an option for Brokers to go directly to the Insurers. However, common practice is for Brokers to go through a General Agent.

We also noted that GEDA did not verify whether the entity issuing Beneficiary 2's policies were current in their renewal of a Broker's license because this was not a required item in GEDA's annual compliance checklist. After we brought the matter to GEDA's attention, GEDA management performed additional research and found that the entity issuing Beneficiary 2's policy also held a license to be a surplus line broker.⁹ According to the DRT Regulatory Division for Insurance, Banking, Securities, and Real Estate, a surplus line broker is not the same as a broker. We also found a General Agent agreement between Beneficiary 2 and the entity issuing its policy. Therefore, we question the 100% rebate benefit that was granted to Beneficiary 2.

GEDA's QC Application Case Analysis and Annual Compliance Reports did not reflect the licensed Guam insurance broker requirement for Beneficiary 2. We recommended that other insurance beneficiaries' files be reviewed to ensure that ineligible tax benefits were not granted. GEDA has provided assurance that other files were reviewed and evidence of a broker's license was obtained.

Based on our review, it appears that GEDA is applying the QC insurance benefits to all insurance companies regardless of type of insurance company it policies are issued through (general agent, broker, surplus, etc.) However, our reading of the law indicates that there is a distinction, which GEDA's own review did not follow or verify. If the 100% rebate cannot be authorized due to the "licensed Guam insurance broker" requirement, GEDA could consider the 75% rebate granted to beneficiaries of other industries as it does not preclude an insurance beneficiary of availing of such tax rebate.

DRT's Lack of Oversight

We found that DRT did not perform its due diligence in ensuring tax benefits were approved in accordance with law. DRT received a copy of and did not find the need to verify Beneficiary 2's QC and Certificate of Compliance (COC) from GEDA. We note that the citation of 12 GCA §58128.4(a) from Beneficiary 2's COC stated the following language:

"The Corporation shall be entitled to a rebate of 100% of all income tax paid by the Corporation to the government of Guam, including all income derived from insurance underwriting either inside or outside of Guam, including all income derived from investing funds derived from operating an insurance underwriting business on Guam, for a period of 20 years from the effective date of this qualifying certificate."

Beneficiary 2's COC excluded the following law excerpt:

"...provided, that as to Guam risks and policy holders the Beneficiary does not issue a policy directly to the policy holder but only issues the same through a licensed Guam insurance broker."

DRT staff processing tax benefits of QC beneficiaries were not familiar with this distinction in the law that could affect the granting of the 100% tax rebate benefit. Since Beneficiary 2's COC did not cite the legal requirement relative to licensed brokers and since Beneficiary 2 held a COC

⁹ Surplus lines of insurance, is when none of the local insurers wants, or is able to, insure a business or entity (http://www.guambusinessmagazine.com/?pg=vol25_04_feature03).

for 2010, DRT processed a 100% income tax rebate to Beneficiary 2. Due to DRT's unfamiliarity with the law, DRT did not verify whether Beneficiary 2's policies were being issued through a licensed broker. We note that DRT has a Regulatory Division responsible for registration of business entities, issuance of general business licenses, and other regulated business licenses, including types of insurance licenses. DRT is able to at least verify whether insurance QC beneficiaries' brokers were licensed.

We question this specific rebate and urge DRT to collect the amount from Beneficiary 2. As the tax administrator and with limited resources, so as to not duplicate the review process performed by GEDA, we recommend for DRT to perform its own review as it deems appropriate to satisfy themselves that all QC beneficiaries are in fact eligible and that the QC tax benefits are correctly computed.

Tax Benefits Not Processed in Accordance with Legal Requirements

Of the six beneficiaries tested, as much as \$9.1M of income tax rebates were incorrectly applied by these beneficiaries and \$5.5M in GRT taxes were exempted instead of abated. We found no evidence that DRT verified such amounts. Specifically, income tax rebates were used as off-sets to existing tax liabilities prior to DRT's authorization; and GRTs were exempted without DRT's certification. These deficiencies are attributed to no cash in the Income Tax Rebate Fund; GEDA and DRT's untimely review; and DRT's lack of monitoring.

Unauthorized Income Tax Rebates

According to the QC law,¹⁰ when a COC is attached to a taxpayer's tax return, the amount of tax due shall be deposited into the Income Fund Tax Rebate Fund at the time of the filing of the return. The Tax Commissioner of Guam shall immediately thereafter cause the return to be reviewed and if a rebate is found in order, the Tax Commissioner will withdraw the rebate amount from the deposited amount and return the amount to the taxpayer within 180 days from the date of the deposit without interest.

Based on DRT's standard operating procedures (SOP), if a rebate is found in order, DRT will notify DOA of the approved rebate amount. If funding is not available, DOA will issue a memo stating such for each QC beneficiary and tax year. If 180 days passed and the rebate remains outstanding, a beneficiary may submit a written request to apply their rebate as a credit to estimated tax or as an off-set to an existing income tax liability. Only after DRT's approval of the request can the beneficiary apply the rebate to the **next** estimated tax due date.

In the six beneficiary files we reviewed, we found no such memo from DOA. According to DOA, the Income Tax Rebate Fund was closed in FY 2007 by PL 29-02 as a result of OPA Report No. 06-03's recommendation to close dormant and inactive funds. The report revealed that the Income Tax Rebate Fund had \$0 balance from FY 2002 to FY 2004. With no cash for income tax rebates, beneficiaries elected to apply their income tax rebates as off-sets to future income taxes.

Two of the six beneficiaries applied their income tax rebates as off-sets prior to DRT's authorization. Beneficiaries 1 and 3 applied income tax rebates in 2008 and 2009 prior to DRT authorizing the amount in 2012. As a result, the offsets affected how much the beneficiaries

¹⁰ 12 GCA Chapter 58.

would have paid to GovGuam. However, the estimated unrealized revenues of \$9.1M would be greater as we found missing tax returns and DRT authorization for tax years 2010 and 2011.

In a letter to DRT, Beneficiary 1 requested DRT to not impose late penalties and interests on its 2009 income tax return due to reasonable cause. Beneficiary 1 cited that, due to GEDA's late issuance of COCs and DRT's untimely authorization of income tax rebates, Beneficiary 1 began to apply its prior year income tax rebates as credits to offset their current income tax liabilities. Beneficiary 1 believed that DRT had the discretion to adjust the offset after DRT's review of the tax return. Beneficiary 1 also claimed that it was not fair for it to be penalized for the government's administrative delays.

Despite the government's cash flow challenges, DRT as the tax administrator has an obligation and duty to perform timely reviews of QC beneficiaries' taxes that may be forgone and not allow offsets contrary to law for the sake of expediency. DRT should consider seeking legislation that would allow them the flexibility to apply offsets and other adjustments as it deems appropriate.

Exemption of Gross Receipts Taxes

The QC law affords insurance QC beneficiaries with 100% *abatement* of GRTs derived from underwriting insurance risks. When a corresponding COC for the previous year is attached to a taxpayer's return for the abated tax, tax payment to GovGuam will not be required. The Tax Commissioner will provide a certification to the taxpayer confirming the nature and amount of abated taxes within 120 days from the receipt of the tax return.¹¹

Abatement, or adjustment, of a tax liability means to reduce or change a tax, penalty, or interest.¹² Meanwhile, a tax exemption means to be free from, or not subject to, taxation by regulators or government entities.¹³ We found that, between 2009 and 2011, DRT exempted rather than abated GRT taxes. The end result between exempted and abated, results in ultimately, no tax to GovGuam. As the tax administrator, DRT should be cognizant and enforce the law accordingly. Abatement results in a liability and payment/adjustment; whereas, exemption results in no liability and no payment in taxes. There is a distinction and accordingly, DRT should follow the law.

For both of the insurance QC beneficiary files we reviewed, the beneficiaries used code E12 that exempted them from paying a total of \$5.5M of GRT during our audit scope. By exempting GRT, the beneficiaries were not required to pay and did not owe any GRT taxes from the QC activity upon filing. However, if the GRT were abated, DRT would have recorded the amount of GRT owed as tax liability on the beneficiaries' accounts. The tax liability will only be removed if the beneficiaries were found to be compliant with their QC requirements and upon DRT confirmation of the nature and amount of the tax benefit.

There was no indication on file to show that DRT has reviewed the \$5.5M claimed by the beneficiaries to be correct, which should have actually been abated rather than exempted. This is attributed to DRT's lack of monitoring as no staff was assigned to review GRTs of QC beneficiaries.

¹¹ Title 12 GCA § 58127.5 and § 58136.

¹² Freedom Tax Relief. www.freedomtaxrelief.com/abatment.php

¹³ Investopedia. http://www.investopedia.com/terms/t/tax_exempt.asp

On September 30, 2011, DRT developed an SOP for GRT abatements. The procedures state that GRTs will no longer be exempted and the use of DRT's GRT exemption code will no longer be allowed. DRT should also review and monitor tax benefits of QC beneficiaries and issue certifications as required by law.

Conclusion

GEDA's QC program was established to encourage investments into Guam. The QC serves as a contract between GovGuam and the QC beneficiary for certain tax benefits in return for meeting certain requirements in the QC law and in the QC. Despite the QC program being in effect for nearly 50 years, both GEDA and DRT's management cannot ascertain the financial impact of the program. We conclude that significant steps must be taken to improve the management and oversight of the QC program and existing legal requirements must once again be examined by high level officials to clarify intent and applicability of the QC process.

A complete and reliable database is needed to help assess the effectiveness of the QC program. GEDA's database only contained information from 2008 to 2012 and has not been reviewed for reliability. The information was derived from beneficiary reports, which appeared to be inconsistent. GEDA has yet to provide us access to the database to enable us to verify information from source documents. DRT was also unable to provide complete files for our review and reconciliation of reported income tax rebates and GRT abatements. Of the six beneficiary files tested, from 2008 to 2012, GovGuam provided approximately \$21.7M of tax benefits. The tax benefits consisted of \$15.4M income tax rebates, \$6M GRT abatements, and \$358K real property tax abatements. The lion's share of the benefits (78%) was granted to insurance beneficiaries.

QCs were awarded regardless of economic impact to GovGuam. For example, although GEDA calculated one QC to provide \$6.4M in taxes over a 20 year period, the forgone tax revenues to GovGuam over the same period amounted to \$101.6M, for an economic loss of \$95.2M. Despite the development of an economic model and the results calculated by such model, GEDA stated that they could not prevent an eligible applicant from receiving all tax benefits allowed by law because the legislative intent was to establish Guam as a financial/insurance center for the Pacific.

Due to GEDA and DRT's weak oversight, however, one insurance beneficiary may have received ineligible benefits. For this beneficiary, we found evidence of a General Agent's license rather than a Broker's license on file, which must be renewed every year. We also noted that GEDA's compliance review checklist did not include this requirement. Such evidence is needed to substantiate the granting of a rebate of 100% of income taxes from insurance underwriting, which was granted to all insurance beneficiaries.

Tax benefits to beneficiaries of the insurance industry were more generous than other industries we reviewed. This includes a 20-year automatic renewal clause if found to be in good standing. For other industries, renewals are subject to the same procedures and considerations as when they first applied for the QC. The QC law should be revisited for elimination of the application of QCs to the domestic insurance industry. As stated previously, GEDA had opposed the expansion of the QC program to the domestic insurance companies.

Recommendations

To improve the QC program's effectiveness, we recommend:

1. GEDA and DRT to collaborate to compile, analyze, and post data on the QC program;
2. The Governor, the Legislature, and the GEDA and DRT Directors to revisit the QC law for elimination of the application of QCs to the domestic insurance industry; and
3. DRT, as the tax administrator, to perform its own due diligence in determining the appropriate tax benefits of eligible QC beneficiaries.

Management Response and OPA Reply

A draft report was transmitted to GEDA and DRT management in July 2013 for their official response. We met with DRT management in July 2013 and GEDA management in August 2013 to discuss the audit findings and recommendations. During our meeting, GEDA and DRT's management generally indicated concurrence with the audit report findings and recommendations. See Appendices 7 and 8 for GEDA's and DRT's official responses, respectively.

The legislation creating the Office of Public Accountability requires agencies to prepare a corrective action plan to implement audit recommendations, to document the progress in implementing the recommendations, and to endeavor to have implementation completed no later than the beginning of the next fiscal year. Accordingly, we will be contacting GEDA and DRT to provide target dates and title of the official(s) responsible for implementing the recommendation.

We appreciate the cooperation and assistance shown during the course of this audit by the staff of GEDA, DRT, and UOG.

OFFICE OF PUBLIC ACCOUNTABILITY



Doris Flores Brooks, CPA, CGFM
Public Auditor

Appendix 1:
Classification of Monetary Impact

Finding No.	Finding Description	Questioned Costs¹⁴	Other Financial Impact¹⁵
1	Financial Impact of QC Program is Unknown	\$ -	Unknown ¹⁶
2	QCs Awarded Regardless of Economic Impact to GovGuam	\$ -	\$ -
3	Ineligible Benefits May Have Been Granted to QC Beneficiaries	\$ XX ¹⁷	\$ -
4	Tax Benefits Not Processed in Accordance with Law	\$ -	Unable to Calculate ¹⁸
Totals		\$ XX	\$ -

¹⁴ Questioned Costs are the costs questioned because of:

- a. an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds;
- b. a finding that, at the time of the audit, such cost is not supported by adequate documentation; or
- c. a finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable.

¹⁵ Other Financial Impact is the amount of lost revenue opportunities and unrealized revenue to the government.

¹⁶ We could not determine the financial impact of the QC program due to GEDA and DRT's unreliable and incomplete database.

¹⁷ Amount is not disclosed due to confidential tax information

¹⁸ We could not calculate the loss opportunity due to time value of money on the \$9.1M offset that was taken by beneficiaries prior to DRT's authorization

Appendix 2:**Objective, Scope, and Methodology**

Our audit objectives were to determine: (1) the financial impact of issued QCs to Guam's economy and (2) whether GEDA administered the QC program in compliance with applicable laws and regulations. The scope of this engagement was from October 1, 2007 to December 31, 2012.

Scope Limitation

Due to GEDA and DRT's unverifiable and incomplete data, we could not determine the financial impact of the QC program to address our first objective.

We were unable to review 2012 beneficiary files and tax returns as the files were still under review by GEDA and DRT at the time of our testing. In addition, of the six beneficiaries we tested, we were unable to review the following DRT files: (1) 2011 income tax return of two beneficiaries, and (2) February, March, May, and July to December 2011 GRT returns of two beneficiaries. Despite several follow-ups, DRT staff was unable to provide these documents before the end of our fieldwork testing. Thus, our report only includes partial information from 2008 through 2011 income tax returns and GRT returns of the six beneficiaries.

Audit Methodology

Our audit methodology included a review of laws, policies, procedures, and other information pertinent to GEDA's QC program. We also performed the following:

1. Walkthroughs and interviews of key officials from GEDA, DRT, and UOG;
2. Analyzed the following information derived from GEDA:
 - a. Certificate of Compliance listing (as of January 2013),
 - b. QC Beneficiary Profile (as of November 2012), and
 - c. Total amount of investments, number of jobs created, and total amount of compensation per industry (2008 to 2012);
3. Selected six beneficiaries as samples for fieldwork testing using judgmental sampling:
 - a. Two insurance beneficiaries based on total investment and most recent QC issued;
 - b. Two hotel beneficiaries based on total investment, most recent QC issued, and QC terms; and
 - c. Two other beneficiaries based on compliance status;
4. Tested the files of six beneficiaries against criteria for eligibility and compliance in three QC program areas: application, compliance, and claiming of tax benefits; and
5. Compiled and reviewed available 2009 to 2011 income tax information of the six beneficiaries, 2009 to 2011 GRT information of two of the six beneficiaries, and 2008 to 2012 Real Property Tax information of one of the six beneficiaries.

We conducted this audit in accordance with the standards for performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. These standards require that we plan our audit objectives and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Except for the scope limitation noted above, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives.

Appendix 3:
Prior Audit Coverage

DOI-OIG released an audit report of GEDA's QC program in September 2001. The audit was conducted to determine whether GEDA (1) effectively administered the QC program, and (2) achieved the program's objectives. The audit scope included a review of QCs issued from October 1, 1997 to June 30, 2000.

The auditors determined that GEDA generally achieved the QC program's purposes. However, the auditors identified internal control weaknesses such as:

- Approval of QCs with unnecessarily generous tax benefits to hotel and tourist industry firms;
- Improperly granted tax abatements to non-compliant beneficiaries, use of surveillance fees for other purposes, and authorization of beneficiaries to receive additional tax benefits while not employing Guam residents;
- Improperly abated gross receipts taxes and use taxes without verification; and
- Exclusion of legally mandated investments and lack of monitoring.

The report listed 14 recommendations to address the findings including: amendments to the QC law, development of SOPs, formal training to compliance and monitoring staff, and coordination with DRT and the Customs and Quarantine Agency regarding gross receipts and use tax abatements.

12 GCA Ch.58 Qualifying Certificates

§ 58100. Legislative Findings and Intent. The Legislature recognizes that the QC program of GEDA was conceived as an economic incentive tool to entice investors into Guam.

§ 58104. Eligibility Defined. A QC shall only be issued to the following entities: Any trust, partnership, sole proprietorship, Limited Liability Partnership (LLP), Limited Liability Company (LLC), or corporation formed under the laws of Guam, or possessions corporation engaged, or about to engage in any of the following activities:

- (a) green technology;
- (b) manufacture, distribution and sale of non-petroleum based fuels;
- (c) agriculture;
- (d) aquaculture;
- (e) mariculture;
- (f) manufacturing;
- (g) commercial fishing;
- (h) services;
- (i) tourism;
- (j) improvement of real property for the economic development of Guam;
- (k) insurance issuance;
- (l) export trading company;
- (m) producing water or disposing of wastewater;
- (n) operating on a military base on Guam [a Base Operating Service (BOS) contract];
- (o) a small business entity [a BOS contract or subcontractor to a BOS contractor]; and
- (p) a global internet infrastructure service.

§ 58105 and § 58105.1 through § 58105.6. Promotion of General Economic Improvement. No QC shall be issued unless GEDA finds that the proposed activities of the Beneficiary [QC recipient] shall promote the general economic development of the territory by:

- 1. Creation of employment; plus
- 2. Replacement of imports; or
- 3. Reduction in consumer prices; or
- 4. Creation of affordable housing or other vitally needed facilities; or
- 5. Creation of economic activity of value to the territory; or
- 6. Establishment of Guam as a financial/insurance center for the Pacific, and increasing the availability and lowering the cost of insurance in Guam.

§ 58109. Authority's Findings on Applications. In making its recommendation to the Governor, GEDA shall consider and make specific findings on the following:

- (a) Impact of the Beneficiary's proposed activities upon Guam businesses and markets;
- (b) Financial risks facing the Beneficiary in undertaking the proposed activities;
- (c) Location of the proposed activities; and
- (d) Importance of the proposed activities to the economy of Guam.

§ 58110. Conditions of Benefits. In its recommendation of specific tax benefits, GEDA shall consider the following as possible terms and conditions to such benefits:

- (a) Percentage of Investment. Limiting the tax benefits to a percentage of the capital investment in Guam to be made by the Beneficiary;
- (b) Variable Rate. Varying the rate of tax benefits over the term of the QC;
- (c) Limitation on Amount. Limiting the tax benefits to a fixed dollar amount;
- (d) Public Investments. Conditioning the tax benefits on the Beneficiary's investing in or creating public improvements separate from its proposed activities;
- (e) Local Shareholders. Requiring the Beneficiary to offer 10% or more of its corporate equity to qualified residents of Guam on terms and conditions established by GEDA;
- (f) Profit-Sharing, etc. Requiring the Beneficiary to establish profit-sharing and stock ownership programs and other similar benefits for its employees;
- (g) Training. Requiring the Beneficiary to: (1) utilize locally-based and locally-owned training services as needed; or (2) establish in-house training programs that consult with locally-based experts as needed; or (3) make contributions to an independent training or scholarship fund.
- (h) Local Purchaser. Requiring the Beneficiary to procure services or products supplied by Guam-licensed vendors if the total cost does not exceed 110% of the cost of the same services or products available from off-island vendors.
- (i) Local Professional Advice and Support. Requiring the Beneficiary to procure and utilize Guam-licensed entities or employ Guam residents that provide professional advice and support in the areas of records access and legal services.

§ 58111. Grounds for Suspension, Rescission or Revocation. A QC may be suspended, rescinded or revoked by the Governor upon the recommendation of GEDA for the following reasons:

- (a) Fraud. Fraud or misrepresentation of any material fact in the QC application;
- (b) Noncompliance with Certificate. Failure to comply with any condition or obligation set out in the QC, the QC law and rules thereof, or any GovGuam laws and rules having a direct impact on the beneficiary's activities. The beneficiary may correct such noncompliance within 12 months from the date it was notified in writing as to the nature and reasons for such noncompliance. All benefits shall be suspended during this noncompliance period. Failure to correct such noncompliance within the period given shall result in revocation of the QC;
- (c) Bankruptcy. The filing by or against the Beneficiary of a petition for bankruptcy;
- (d) Dissolution or death. A finding by the Attorney General that a corporate or partnership Beneficiary has been dissolved, or that an individual Beneficiary has died;
- (e) Noncompliance with laws and rules. Failure to comply with any provision of 12 GCA Ch.58 or with the applicable rules and regulations of GEDA.

§ 58112. Hearing Required. No recommendation for suspension, rescission or revocation of a QC shall be made by GEDA except after a hearing thereon pursuant to the Guam Administrative Rules and Regulations.

§ 58113. Retroactive Suspension. The suspension, rescission or revocation of a QC may be retroactive to the time of the act or omission giving rise to the suspension, rescission or revocation or for any shorter period recommended by GEDA.

§ 58114. License Required. A QC shall not be issued to any applicant who has not first obtained a license to do business in Guam.

§ 58116. Employment of United States [U.S.] Citizens and Permanent Residents. Every QC shall require that the Beneficiary submit a plan for a management training program for the approval of GEDA. The plan shall establish a management training program through which the Beneficiary shall have as managers and officers Guam residents who are citizens or permanent residents of the U.S.

§ 58117. Same: Work Force. (a) Minimum Size. A Beneficiary shall at all times employ a total work force of not less than the minimum full-time equivalent number established by GEDA and as set out in the QC. However, at all times, the work force of a Beneficiary shall meet the following minimum requirements:

- 1) Initial Minimum Requirement. At least 75% of the Beneficiary's non-managerial employees shall be citizens or permanent residents of the U.S.; and
- 2) Subsequent Minimum Requirement. After the expiration of 3/4ths of the period of the QC or 10 years, whichever is sooner, the Beneficiary shall satisfy the 75% employment requirement for both management and non-management employees.

(b) Management and Non-Management Employees. GEDA shall be the judge of whether a Beneficiary's employee is management or non-management but it may seek advice from UOG, the Guam Community College [GCC], the Department of Labor [DOL], or such other government agencies as are helpful in advising on carrying out the provisions of this Section. GEDA shall establish by regulation the requirements for practical and equitable training programs as guidance for the Beneficiary and the reasonable minimum number of persons to be employed on a continuing basis for each Beneficiary in accordance with the specific and normal requirements of the business involved. GEDA shall annually report to the Legislature the titles and compensation of all trainees, including those placed in management levels, who are employed by QC Beneficiaries.

§ 58118. Same: Wages. No resident employee of a Beneficiary shall be paid at less than the prevailing wage rate nor shall such employee be laid off work nor have his or her workweek reduced to less than 40 hours in order to create employment for employees who are not citizens or permanent residents of the U.S.

§ 58120. Participation in Training Programs. Every QC which covers the operation of a hotel or restaurant shall require its Beneficiary to participate in:

- 1) the GCC Hotel/Restaurant Industry Apprenticeship Training Program or other subsequent and similar programs approved by GEDA; and

- 2) the UOG Management and Supervisory Training Program or other subsequent and similar programs approved by GEDA.

§ 58123. Monthly Reports. The QC Beneficiary must furnish monthly written reports to GEDA beginning 30 days after the date of the QC issuance. Said reports must include, but are not limited to, financial, employment and payroll data. All such monthly reports shall be treated as confidential by GEDA.

§ 58124. Publication of All Applications for Qualifying Certificates. GEDA shall cause to be published, at the applicant's expense, in a Guam newspaper of general circulation, a brief résumé of an application for a QC, said publication to be made no later than 7 days following submission of an application. The résumé shall be in a form prescribed by GEDA, and it shall include the name and address of the applicant, a brief statement of the proposed investment, a brief summary of the tax rebates and abatements applied for, and the names and addresses of all the owners, partners, or shareholders of the Applicant. Following the filing of the application in due form, payment of the prescribed fees and publication of the résumé, a public hearing shall be held pursuant to the GAR.

§ 58125. Notice of Hearing on Applications. A notice of the public hearing shall be published at the applicant's expense in a Guam newspaper of general circulation in a form prescribed by the Authority between 5 to 10 days before the scheduled public hearing date. The GEDA meeting for approval or disapproval of a QC shall not be held on the same day as a public hearing on the same QC application.

§ 58126. Recommendations. All recommendations of GEDA for issuance, modification, renovation and suspension of QCs shall be forwarded to the Governor of Guam, together with a memorandum of findings in support of its recommendations. Any recommendation of GEDA not approved by the Governor within 60 calendar days from his receipt thereof shall be deemed disapproved on the 61st day following such receipt.

§ 58127, § 58127.1 and § 58127.5 Tax Abatements.

Subject to the provisions of this Chapter, the Governor is authorized to issue a QC including the abatement of:

- 1) *Property Taxes.* All taxes now levied by the Real Property Tax Law (11 GCA Ch.24) shall be abated for a period up to 10 years from the effective date of the QC, and as long as said QC is in force and effect.
- 2) *Insurance Premiums.* All taxes now levied by business privilege taxes shall be abated for a period of up to 20 years from the effective date of the QC, for those gross receipts derived from underwriting insurance risks either in or out of Guam, including gross receipts derived from investing funds generated from insurance underwriting in Guam by an insurance company that has qualified and continues to qualify for a QC. Such insurance QCs may be renewed for additional periods for 20 years at the conclusion of the first or later periods so long as the Beneficiary remains in good standing under the laws of Guam and under GEDA's rules and regulations.

§ 58128, § 58128.1, § 58128.2, § 58128.3, § 58128.4(a), and § 58128.4(b) Tax Rebates. Subject to the provisions of this Chapter, the Governor is authorized to issue a QC which establishes the following tax rebate:

- 1) *Income Tax Rebate.* A rebate of up to 75% of all income tax paid to GovGuam by a Beneficiary on income received from those activities identified in the QC may be issued for a period not to exceed 20 consecutive years from the effective date of a QC.
- 2) *Variable Rates.* The percentage of rebate may be made variable by GEDA so as to permit higher or lower percentages in earlier or later years of the period. In determining the periods up to 20 years and the percentages up to 75%, GEDA shall take into consideration the financial risks involved in the undertaking as well as the impact on the socio-economic development of Guam by the proposed investment.
- 3) *Determination of Income.* For the purposes of this Section, the term “income tax paid” shall mean income taxes paid on income received on or after the effective date of the applicable QC. The DRT Director shall have authority to determine any prorations of rebates necessary because of taxable years occurring within the life of the applicable QC which consist of less than 12 months.
- 4) *One Hundred Percent Rebate on Certain Insurance Income.* (a) A rebate of 100% of all income tax paid to GovGuam by a Beneficiary on all income received from insurance underwriting either inside or outside of Guam, including all income derived from investing funds derived from operating an insurance underwriting business on Guam, may be issued for a period not to exceed 20 consecutive years from the effective date of a QC therefore; **provided, that as to Guam risks and policy holders the Beneficiary does not issue a policy directly to the policy holder but only issues the same through a licensed Guam insurance broker** [emphasis added]. Such insurance QCs may be renewed for additional periods of 20 years at the conclusion of the first or later periods so long as the Beneficiary remains in good standing under the laws of Guam and under GEDA’s rules and regulations. (b) A rebate of 100% of the income tax withheld from the shareholders of an insurance underwriting business on the dividends from such business may be issued for a period not to exceed 20 consecutive years from the effective date of the QC. If the shareholder is a resident of Guam then such shareholder may be granted a QC on dividends pursuant to § 58130. Such QCs for non-resident insurance shareholders may be renewed for additional periods of 20 years at the conclusion of the first or later periods so long as the Beneficiary remains a shareholder of an insurance underwriting business that is the holder of its own QC and is in good standing under the laws of Guam and under GEDA’s rules and regulations.

§ 58130. Income Tax Rebate on Dividends. A rebate of up to 75% of the income tax paid by the shareholders of a corporation on the dividends of that corporation may be granted for a period not to exceed five (5) consecutive years.

§ 58132. Modification of Tax Benefits. In the event that a Beneficiary proposes to substantially expand or add to its activities and desires to obtain a modification of its original QC to include its proposed additional activities, then upon GEDA’s findings and recommendations, the Governor may modify the original QC, subject to the following conditions:

- (a) Findings. GEDA specifically finds that the additional proposed activities of the Beneficiary satisfy the requirements of § 58103 and § 58106 and that GEDA makes recommendations required by § 58109;
- (b) Cancellation of original Certificate. The original QC shall be surrendered and cancelled; and
- (c) Changes in benefits. The tax benefits applicable to the additional activities may be at rates or for a term different from those tax benefits applicable to the activities described in the original QC, and the new QC may include terms, conditions, rebates or abatements different from those in the original QC.

§ 58133. Extended Term. In lieu of the percentage of tax abatements and rebates authorized in this Chapter, GEDA may recommend and the Governor may grant 50% of said abatements and rebates for a period of double the term authorized by this Chapter.

§ 58134. Acknowledgment of Benefits by Tax Commissioner. When GEDA forwards its recommendations to the Governor on the issuance of a QC, it shall transmit a copy of such recommendations to the Tax Commissioner of Guam for his information. The Tax Commissioner shall forthwith acknowledge in writing to the Governor and GEDA that the proposed tax benefits are understood and accepted by DRT.

§ 58135. Procedure to Claim Abated and Rebated Taxes. GEDA shall monitor the activities of the Beneficiary and its compliance with all of the terms and conditions of the QC, this Chapter and GEDA's regulations and it shall, if justified, issue annually its COC by the Beneficiary. No rebate or abatement of any tax shall occur unless the Beneficiary shall have received a COC for the applicable tax year.

§ 58136. Abatement of Tax. When the return for the abated tax is accompanied by a corresponding COC for the previous year or part thereof then the actual payment of the tax in question to GovGuam shall not be required, and upon review of the tax return, the Tax Commissioner of Guam shall, within 120 days from receipt of said tax return, furnish the taxpayer a certification confirming the nature and amount of the tax abated.

§ 58137. Rebate of Tax. In the case of an income tax rebate, where the taxpayer's tax return is accompanied by a COC, the amount of a tax due prior to rebate shall be deposited with GovGuam at the time of filing the income tax return. The Tax Commissioner of Guam shall immediately thereafter cause the return to be reviewed and if the rebate is found in order shall cause the amount of the rebate to be withdrawn from the deposit and returned to the taxpayer within 180 days from the date of the deposit, without interest. The balance of the deposit shall be credited against the taxpayer's income tax obligation to GovGuam.

§ 58138. Rebate Fund. Deposits for income tax made with GovGuam pursuant to this Chapter shall be covered and deposited into a separate, special account in the Treasury of the territory of Guam, to be designated the Income Tax Rebate Fund.

§ 58142. Investment of Abated or Rebated Tax in Guam. Each QC, except for a QC issued to an insurer pursuant to the provisions of §§ 58127 and 58128 of this Article, shall require a Beneficiary to invest within Guam no less than 50% of any taxes rebated or abated under §§ 58127 and 58128 of this Article for a period of 5 years following the rebate or abatement. A Beneficiary shall report all such investments to GEDA.

22 GCA Ch.12 Insurance Law

§12104. Definitions.

- (h) Agent means both general agent and sub-agent, unless otherwise apparent from the context.
- (j) Broker means a person who, for compensation and on behalf of another person, transacts insurance business other than as insurer, general agent, sub-agent or solicitor.
- (p) General Agent means a person authorized by an insurer to countersign, issue and deliver new policies, to accept service of process on behalf of the insurer, and vested with full authority to consummate a contract of insurance and to transact all other necessary business of the insurer in Guam.
- (r) Insurer means the person who undertakes to indemnify another by insurance; insured means the person so indemnified.

16 GAR Ch.4 Issuance of Qualifying Certificates

§4102. Requirements. Any applicant for a QC must meet the following requirements:

- (a) The applicant shall be duly licensed to do business in Guam.
- (b) Upon filing an application, the applicant shall certify in writing that it shall at all times employ at prevailing wage rates a total employment force of which at least 50% shall be either citizens or permanent residents of the U.S.; provided, however, that for reasons of hardship, satisfactory to the Board, temporary exemptions hereto, for specific periods of time, may be granted by the Board.
- (c) The applicant must agree to furnish written monthly reports beginning 30 days after the date of the QC issuance, said reports to include, but not limited to, financial data, employment data and payroll data.

§4103 (c) and (e). Minimum Investment. An applicant must undertake to invest in a new industry or business in Guam:

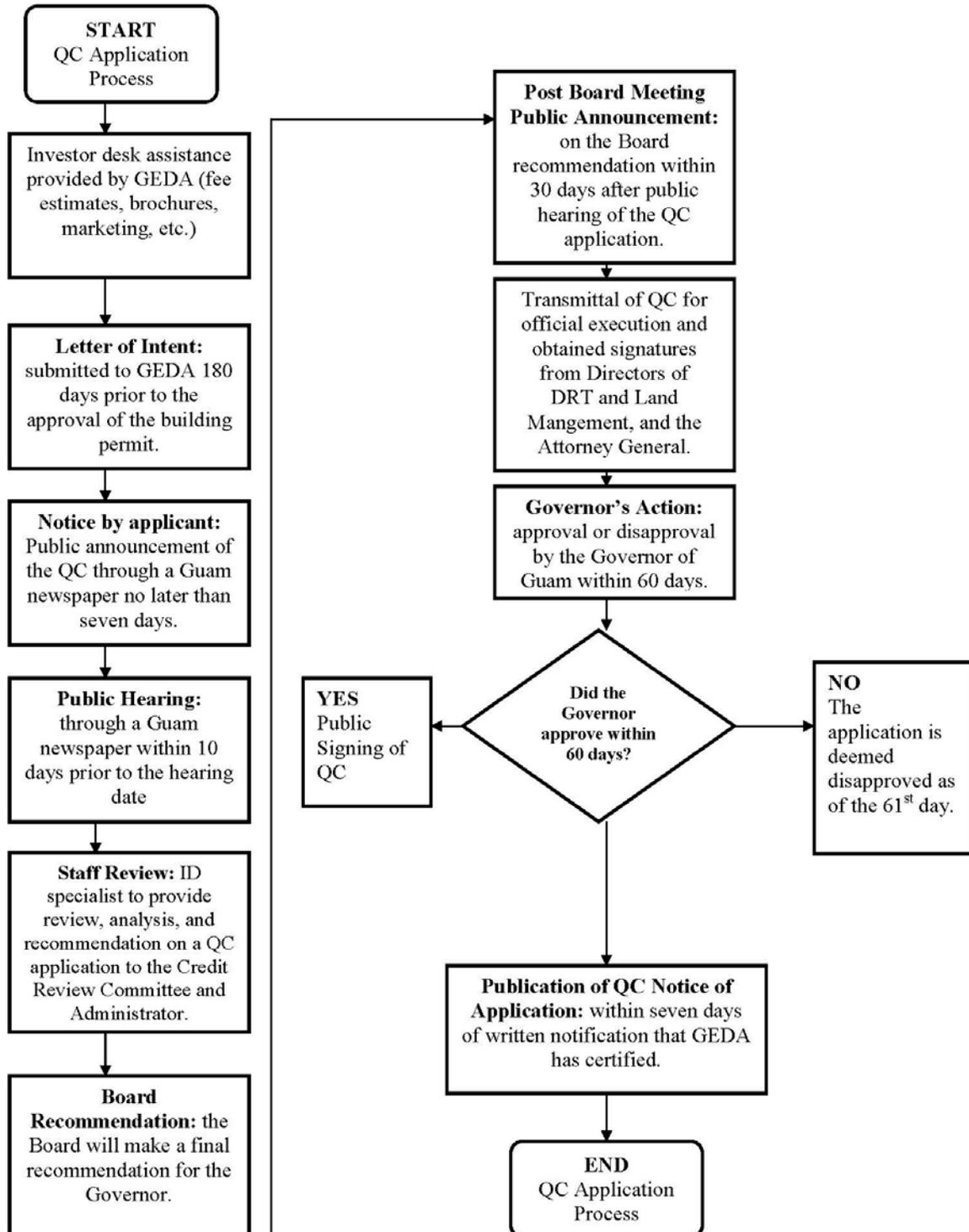
- (c) Sufficient investment to construct a first-class tourist hotel having at least 100 rooms, and with at least \$250K paid-in-capital, constructed in accordance with plans and specifications filed with and approved by the government agencies and authorities concerned. Tax benefits to be granted shall be at the discretion of the Board of Directors.
- (e) For the purpose of satisfying the amount of minimum paid-in-capital required in the foregoing Subsection, the appraisal value of land necessary and vital to the operation of such business or industry (as determined by the Board) and previously existing buildings (as appraised for tax purposes) may be included, but shall not exceed such percentage of the total amount of investment required as is deemed by the Board appropriate to the enterprise contemplated by the applicant.

16 GAR Ch.5 Joint Regulations for Tax Abatement and Rebates Pursuant to P. L. 8-80.

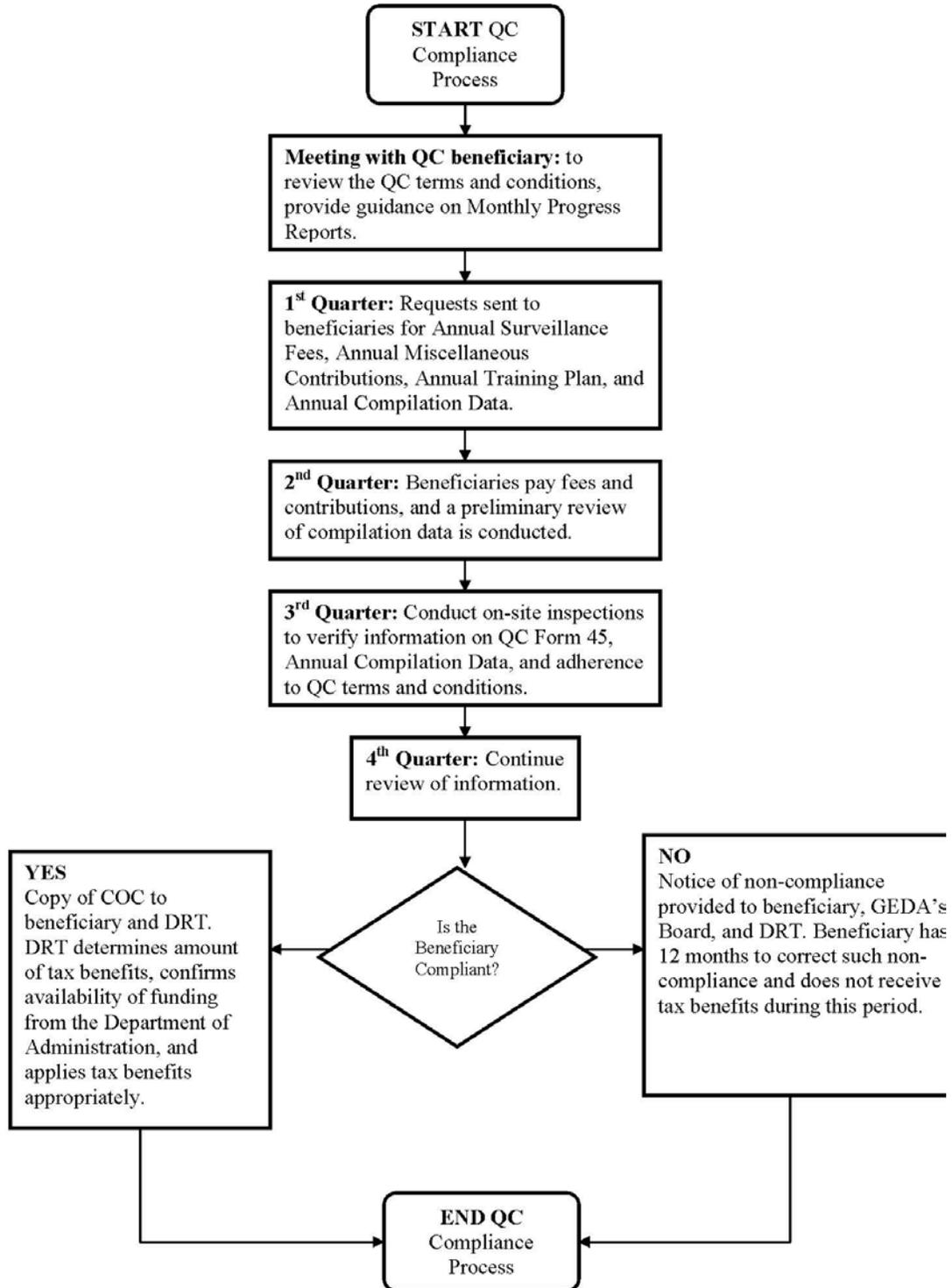
§ 5102(c). Establishment of Tax Abatements. Title 12, Guam Code Annotated §58128 provides that the following tax abatements are hereby established and declared, for which Qualifying Certificates may be issued:

(c) All taxes now levied by virtue of 11 GCA Chapter 26, known as Real Property Tax, shall be abated for a period up to ten (10) years from date of issuance of Qualifying Certificate therefor and as long as said Certificate is in force and effect, provided that the real property on which said tax is assessed is utilized for a tax exempt business that has qualified and continues to qualify for a Qualifying Certificate.

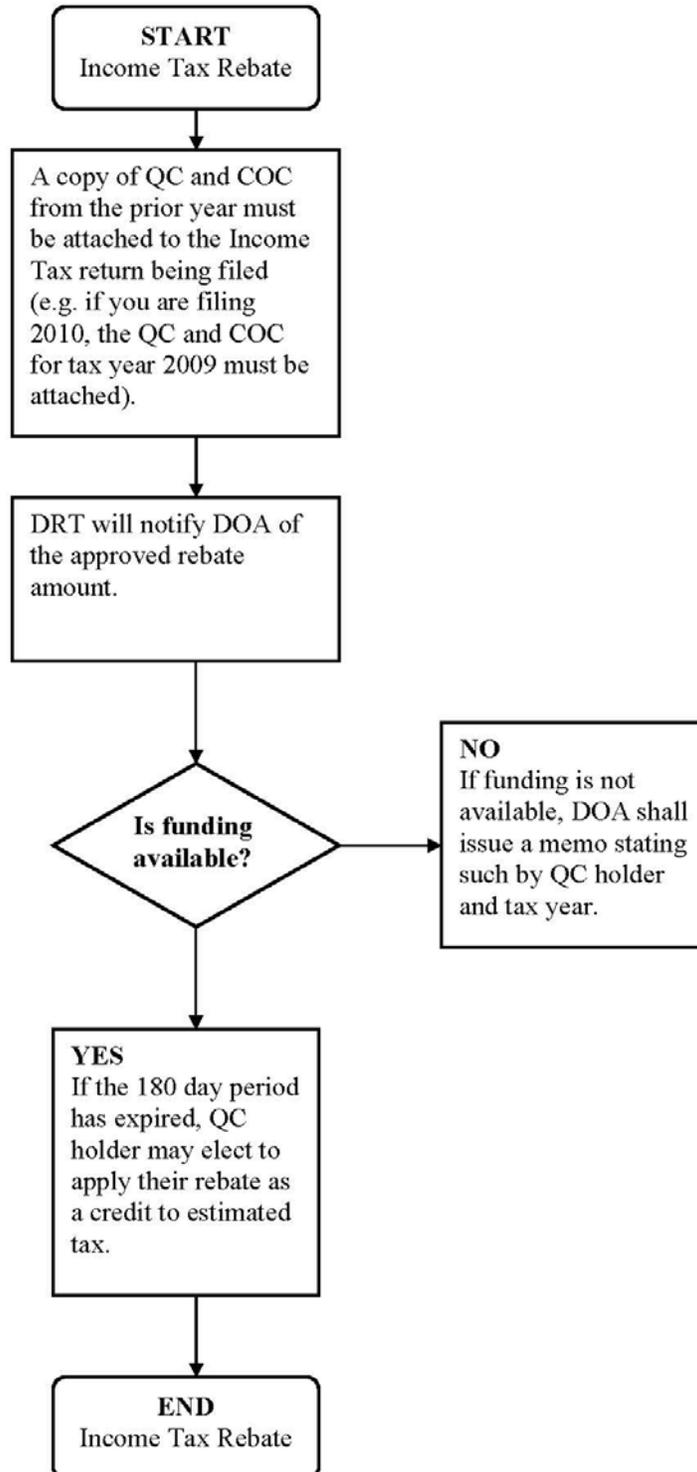
GEDA's QC Application Process



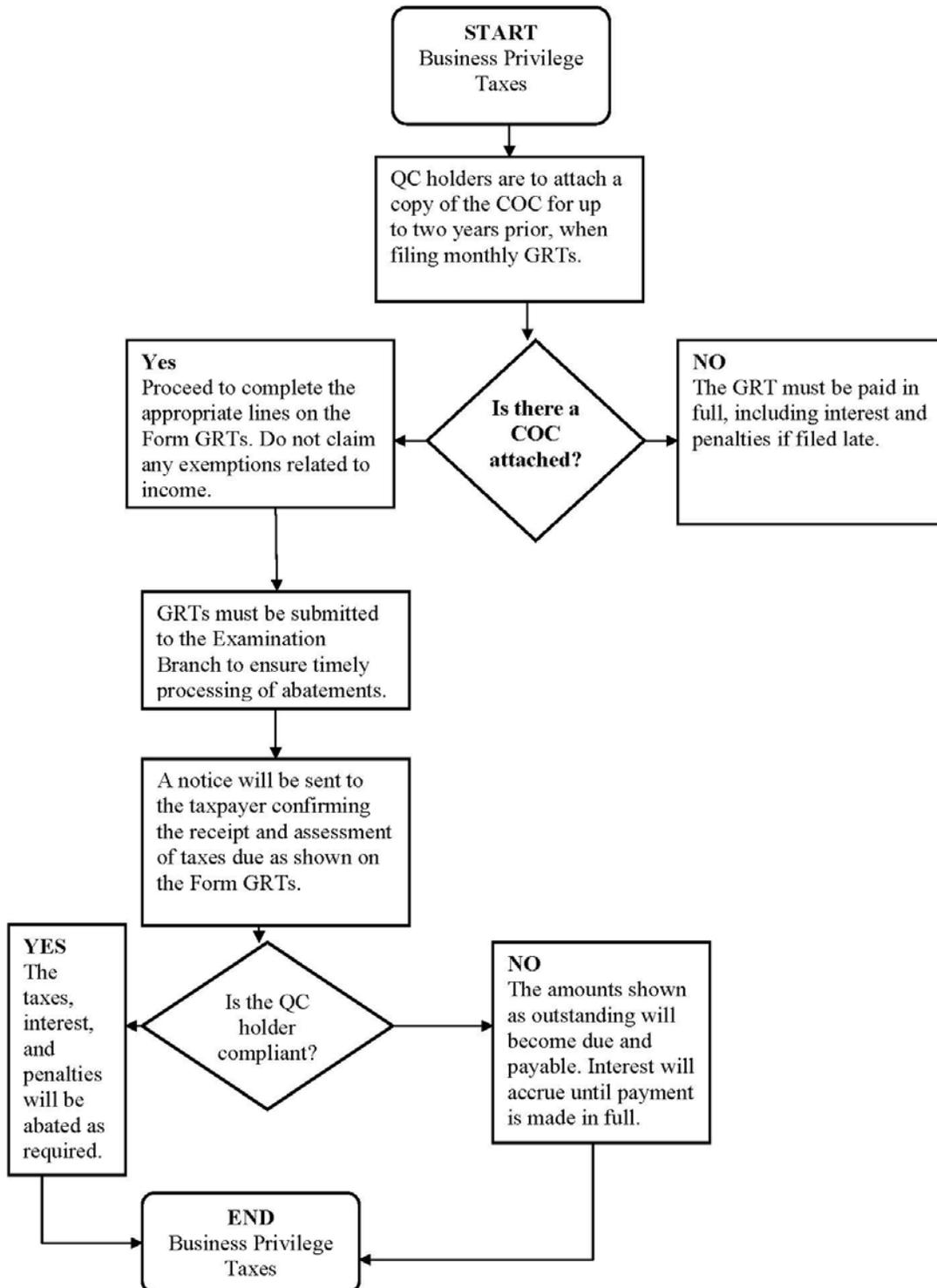
GEDA's Compliance Review Process



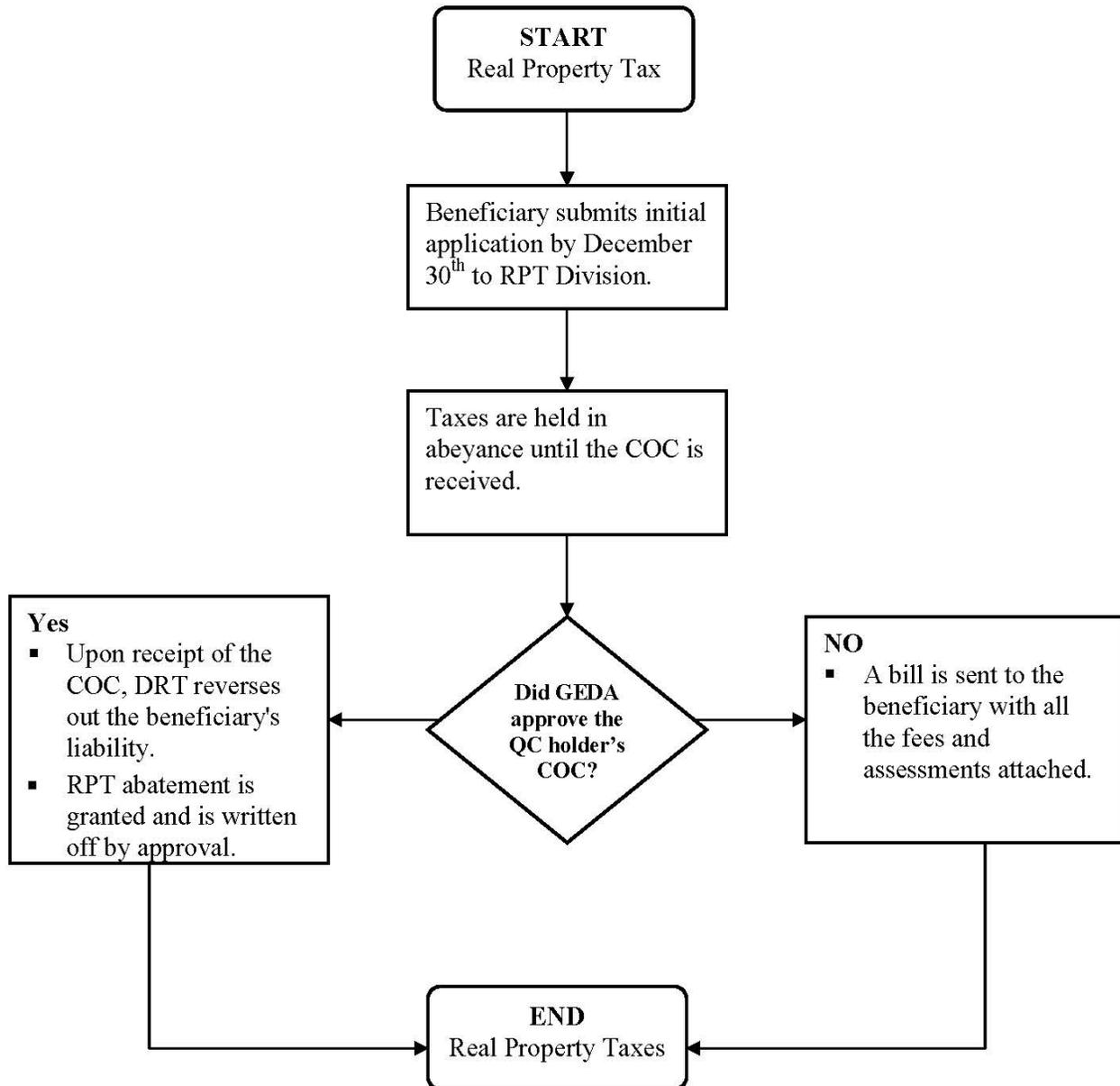
DRT's Tax Rebate Process



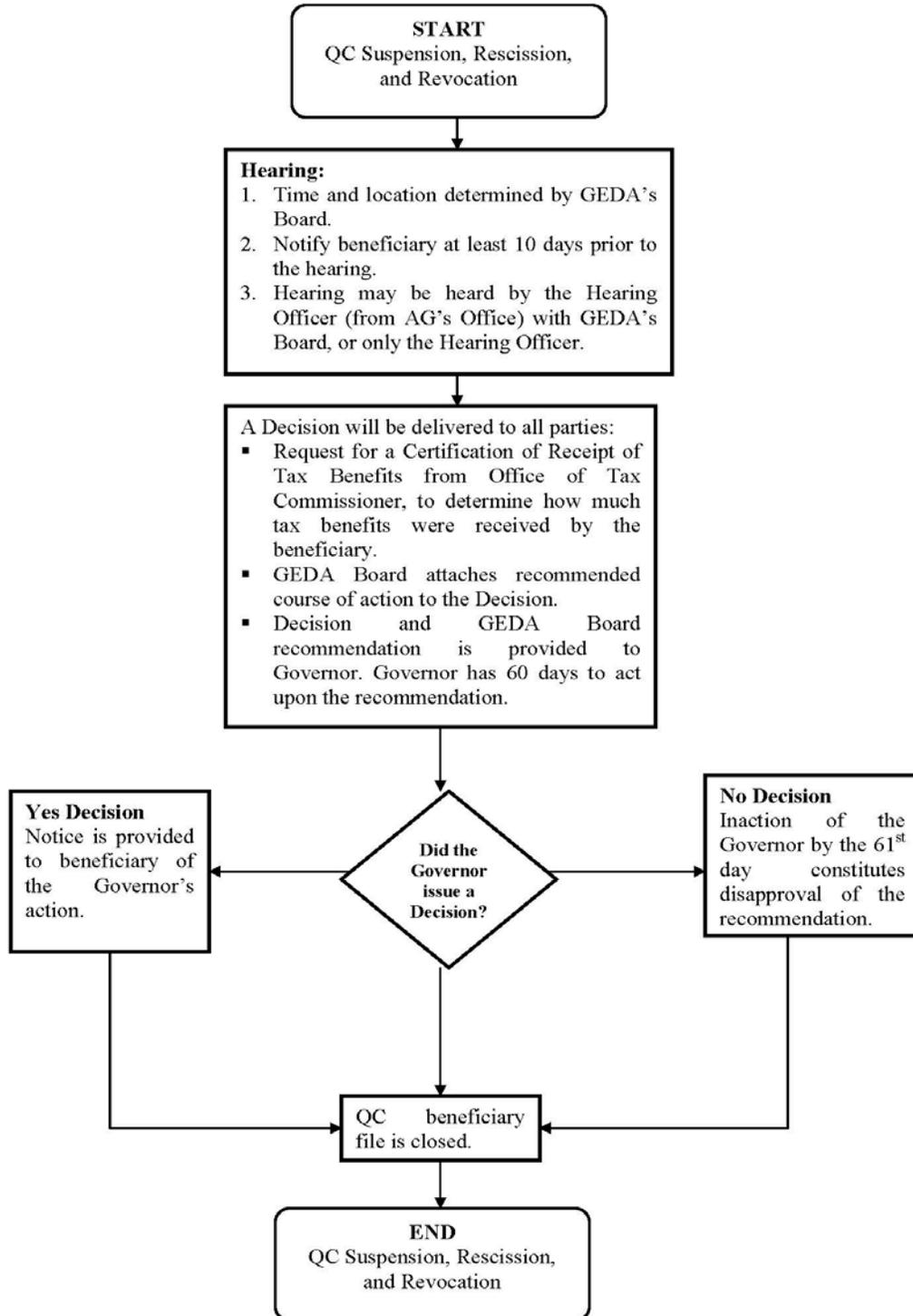
DRT's GRT Abatement Process



DRT's Real Property Tax Abatement Process



GEDA's Suspension, Rescission and Revocation Process





**U.S. Department of the Interior
Office of Inspector General**

Audit Report

Qualifying Certificate Program Guam Economic Development Authority Government of Guam



**Report No. 01-I-419
September 2001**

U.S. Department of the Interior**Office of Inspector General****EXECUTIVE SUMMARY****Qualifying Certificate Program,
Guam Economic Development Authority,
Government of Guam
Report No. 01-I-419
September 2001**

The Guam Economic Development Authority was established in August 1965 as a public corporation "to assist in the implementation of an integrated program for the economic development of Guam" and "to be a catalyst in the economic development" of Guam by "aiding private enterprise without unfairly competing with it." The Authority is authorized to provide loans, issue revenue bonds, purchase mortgages, and function as the Government's financial advisor and as manager of industrial park leases. In addition, the Authority encourages private sector investment by granting tax rebates and abatements to qualifying businesses under the Qualifying Certificate Program.

The objective of our audit was to determine whether the Guam Economic Development Authority (1) effectively administered the Qualifying Certificate Program and (2) achieved the objectives for which the Program was established.

Although the Qualifying Certificate Program provided significant benefits to the Guam economy, we found that there was a need for improvements in the Program. Specifically:

- The Government of Guam lost tax revenues of at least \$769,650 and could lose future tax revenues totaling about \$70.8 million because the Authority recommended the approval of Qualifying Certificates with unnecessarily generous tax benefits to hotel and tourist industry firms that may not have needed the level of tax benefits given.
- The Authority improperly granted tax abatements of \$459,777 to beneficiaries that were not in compliance with their Qualifying Certificates, apparently used surveillance fees of about \$220,000 for purposes other than monitoring beneficiary compliance, and authorized beneficiaries to receive additional tax benefits of at least \$815,990 while concurrently allowing the beneficiaries to not employ about 371 Guam residents.
- Gross receipts taxes of more than \$5 million and an undetermined amount of use taxes were abated improperly and without verification of the amount or eligibility.
- Legally mandated investments in Guam's economy totaling at least \$2.3 million may not have taken place because the Authority did not include language in Qualifying Certificates

requiring beneficiaries to reinvest tax benefits and, for those Certificates that included the reinvestment requirement, did not monitor the beneficiaries' compliance.

We made 14 recommendations to the Chairman of the Authority's Board of Directors to address these issues by seeking changes to the Qualifying Certificate law, developing standard operating procedures for some of the Authority's activities, providing formal training to compliance monitoring staff, and coordinating with the Division of Revenue and Taxation and the Customs and Quarantine Agency regarding gross receipts and use tax abatements.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL EVALUATION

The Authority concurred with 8 of the report's 14 recommendations, partially concurred with 1 recommendation, and expressed nonconcurrence with the other 5 recommendations. Based on the response, we considered 6 recommendations unresolved and requested additional information for 8 recommendations.

Appendix 7: GEDA Management Response

Page 1 of 1



EDWARD J.B. CALVO
GOVERNOR OF GUAM
I MAGA' LAHEN GUAHAN
RAYMOND S. TENORIO
LT. GOVERNOR OF GUAM
I SEGUNDO NA MAGA' LAHEN GUAHAN
HENRY J. TAITANO
ADMINISTRATOR
ADMINISTRADOT

August 5, 2013

Doris Flores Brooks, CPA, CGFM
Public Auditor
Office of Public Accountability
Suite 401, DNA Building
238 Archbishop Flores Street
Hagatna, Guam 96910

Subject: Response to Draft Audit Report: Guam Economic Development Authority Qualifying Certificate (QC) Program from 2008 through 2012

Hafa Adai Ms. Brooks,

I would like to thank you for the opportunity to provide a response to the findings of your performance audit conducted on Guam's Qualifying Certificate program as administered by GEDA. Pursuant to the meeting held on Friday, August 2nd here at the GEDA offices, we have the following responses to the *Conclusions and Recommendations* made in the report.

Recommendation #1: GEDA and DRT collaborate to compile, analyze data on the QC Program.

GEDA Response: GEDA hereby agrees with this and, by its own initiative, started development of a statistical database on the program for the past 5 years or from 2008 to 2012. This database is in the development stage and once information has been validated, will be available for reporting.

Recommendation #2: The Governor, the Legislature, and the GEDA and DRT Directors establish a task force to revisit the QC Law.

GEDA Response: As the OPA report correctly states, there was a 1-year moratorium on the QC program in 2009 to allow for a review by the Tax Review Commission and members of the community (PL 29-19 Section 73). A report was submitted to the Guam Legislature but action was not taken on the 2009 report. GEDA is now working with our Legislative oversight Committee Chair to finally implement those changes in the next few months via Legislative amendments.

In conclusion, I thank the Office of Public Accountability for working closely with GEDA during the course of this audit. We look forward to working with your office in future as we continue to find ways to strengthen the GEDA Qualifying Certificate Program. *Si Yu'os Ma'ase!*

Senseremente,


Henry J. Taitano
ms Administrator

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"THIS INSTITUTION IS AN EQUAL OPPORTUNITY PROVIDER AND EMPLOYER".

Appendix 8:
DRT Management Response

Page 1 of 1



Dipáttamenton Kontribusiyan Adu'ána
DEPARTMENT OF
REVENUE AND TAXATION
GOVERNMENT OF GUAM Gubetnamenton Guåhan

EDDIE BAZA CALVO, Governor Mags'åhñi
RAY TENORIO, Lt. Governor Tifente Gubetnadot

JOHN P. CAMACHO, Acting Director
Actot Direktot
MARIE M. BENITO, Deputy Director
Segundo Direktot

August 6, 2013

Doris Flores Brooks, CPA, CGFM, Public Auditor
Office of Public Accountability
Suite 401, DNA Building
258 Archbishop Flores Street
Hagatna, GU 96910

RE: Management Response – Audit Report on the Guam Economic Development Authority (GEDA)
Qualifying Certificate (QC) Program from 2008 to 2012

Buenas Yan Saludas:

The Department of Revenue & Taxation (DRT) hereby submits management's responses regarding the findings and conclusions as detailed in your audit report. DRT concurs with all recommendations but with clarification on Recommendation 4—DRT would conduct due diligence by reviewing all Certificates of Compliance for unusual or extraordinary changes to insure eligibility is met but not duplicate or replace the review process required by GEDA, prior to applying any tax or rebate benefits. Also, DRT reminds the OPA that records that were unavailable for review resulted from the termination of the old POS system and the lack of a new system to replace it (still work in progress). Furthermore, DRT also clarifies and requests that paragraph 4 on page 7 be changed or stricken "*We were informed that one person took it upon herself...*" as that was an assigned duty to that individual and not volunteered.

DRT also requests the OPA's concurrence to be included in audit report that mandatory electronic filing, at minimum, for all local taxes, should be implemented and could result in more efficient audits of Government of Guam agencies and DRT.

Should you have any concerns on this matter, feel free to contact me at 635-1815.

Senseramente,


JOHN P. CAMACHO
Director



Guam Economic Development Authority
Qualifying Certificate Program
Report No. 13-02, August 2013

ACKNOWLEDGEMENTS

Key contributions to this report were made by:
Llewelyn Terlaje, CGAP, Audit Supervisor
Joy Bulatao, Auditor in Charge
Travis Carbon, Audit Staff
Doris Flores Brooks, CPA, CGFM, Public Auditor

MISSION STATEMENT

**To improve the public trust,
we audit, assess, analyze, and make recommendations
for accountability, transparency,
effectiveness, efficiency, and economy of the government of Guam
independently, impartially, and with integrity.**

VISION

Guam is the model for good governance in the Pacific.

CORE VALUES

Integrity	Independence	Impartiality
Accountability	Transparency	

REPORTING FRAUD, WASTE, AND ABUSE

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- Visit our website at www.guamopa.org
- Call our office at 475-0390
- Fax our office at 472-7951
- Or visit us at Suite 401, DNA Building in Hagåtña;

All information will be held in strict confidence.